Self-dealing; transfer of property subject to lien. A disqualified person's transfer to a private foundation of real property that is subject to a lien placed on the property by the disqualified person within the 10-year period ending on the transfer date is an act of self-dealing, even though the lien was created merely as part of a multiphase financing plan begun more than ten years earlier.

Advice has been requested whether, under the circumstances described below, the transfer of certain real property to a private foundation by a disqualified person with respect to the private foundation constitutes an act of self-dealing within the meaning of section 4941 of the Internal Revenue Code of 1954.

The private foundation is an irrevocable inter vivos charitable trust that was created on October 23, 1968. It is exempt from federal income tax under section 501(c)(3) of the Code. The trustees are the creator and his two sons.

The creator, a disqualified person with respect to the private foundation within the meaning of section 4946(a)(1)(A) and (B) of the Code, is a co-founder and major shareholder of a publicly held corporation. On December 21, 1964, the creator purchased certain undeveloped real property. The property was acquired with the intention of constructing an office building that would serve as the headquarters for the corporation. At the time the property was acquired, the creator executed a deed of trust in favor of the seller as security for the unpaid balance of the purchase price. The deed was recorded with the appropriate State officials on December 21, 1964. Included in the deed of trust was a subordination provision allowing the creator to use the property as security against additional loans that might be taken in the future for the purpose of constructing improvements thereon.

On April 27, 1966, a contract for the construction of the office building was executed. On September 1, 1966, the corporation entered into a lease agreement with the creator with respect to the office building. The lease agreement contained a condition that construction of the office building be completed.

Following completion of the office building, a permanent loan was obtained from an unrelated third party. The deed of trust securing this loan was recorded on December 5, 1967. The proceeds from the permanent loan were used to pay off a construction loan previously advanced by the corporation and to pay off various additional construction costs.

On December 26, 1974, the creator conveyed his entire interest in the land and the improvements thereon to the private foundation. The deed, which recited on its face that it was made as a gift and without consideration, was recorded on December 27,
1974. The private foundation did not assume the existing liens, but did accept the gift subject to them.

Section 4941(d)(1)(A) of the Code defines the term 'self-dealing' to include any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person.

Section 4941(d)(2)(A) of the Code states that the transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

Section 53.4941(d)-2(a)(2) of the Foundation Excise Tax Regulations provides that the term 'similar liens' shall include, but is not limited to, deeds of trust.

In the present case, the original lien created by the deed of trust executed in conjunction with the purchase of the undeveloped real property was placed upon the property prior to the 10-year period ending on the date of transfer, December 26, 1974. However, the lien created by the deed of trust executed in conjunction with the permanent loan was placed upon the land on December 5, 1967, a date within the 10-year period. For purposes of section 4941(d)(2)(A) it does not matter that the taxpayer placed the second lien on the property as part of a multiphased financing program begun more than ten years before the date of transfer.

Accordingly, the transfer is treated as a sale or exchange of property between a private foundation and a disqualified person and constitutes an act of self-dealing within the meaning of section 4941 of the Code.